OREGON STATISTICAL REVIEW, AUGUST 1961

(For details see pp. 9-10)

Although the economy of the United States appears to be working its way out of the recession of 1960-61, certain industries are lagging. Lumber and plywood production are among these laggards, a situation which is of considerable importance to Oregon. The reason for the rather poor showing of lumber and plywood production is that one-family home construction constitutes a key market for these products and housing starts have been slipping with the result that they are below the levels of a year ago. Slowness in the principal manufacturing industry of the state is reflected in a number of other indicators.

Although August manufacturing employment was off 3,900 compared to one year ago, and construction (largely because of a strike) was off 6,500, other activities—principally government—utilized enough additional workers so that total employment was up 6,500. On the other hand, the unemployment rate rose from 3.9 per cent in August 1960 to 4.4 per cent in August 1961.

• **Building permit** totals were down a third this August from a year ago. This was partly because the level last year was unusually high. This had resulted from the $6 million Hilton hotel permit and the $7.6 million post office permit in Portland and a $1 million dormitory permit at Willamette University in Salem.

• **Bank debits** were off almost 2 per cent compared to one year ago; the two areas accounting for the downturn were the Portland and Pendleton areas.

• **Business failures** in Oregon for the first eight months of 1961 total 334, a decrease of 17 per cent in number from the comparable period in 1960. The cumulative liabilities, however, total $11,044,000, an increase in value of 22 per cent.

• **Average weekly earnings** of production workers in manufacturing industries were $101.63 in August of this year, a decrease of 93 cents below July. The average continues to remain above the figure for one year earlier.

• **The Douglas Fir Plywood** Association's latest quarterly report on fir plywood production, orders, and shipments is for 149 plants in Washington, Oregon, California, and Montana. Recent census data imply that approximately two-thirds of the production comes from mills operating in Oregon. The totals are in millions of square feet.

	Jan. through June		*Per cent of*
	1961	*1960*	*change*
Production	4,159	4,084	+ 1.8
New orders	4,300	3,737	+15.0
Shipments	4,189	3,924	+ 6.8

The Functions and Responsibilities of Financial Management

By CHARLES E. JOHNSON
Professor of Accounting and Department Head, University of Oregon

Few executive jobs in the business hierarchy are so loosely bounded as that of the controller. The task may be defined so narrowly it amounts to not much more than record keeping; it may be broadened in scope until the president of the company looks like an administrative assistant. In many companies, it is clear that the job is defined more by the man who holds it than by the organization manuals. I have seen important elements of the controller's functions performed by an economist in a meat packing concern, and by a chemical engineer in an oil company. And this is not surprising upon reflection, because the *functions* of the controller exist whether the job, or the man, or either are present.

As an educator of what we hope will be the business leaders of tomorrow, I have, of course, given a lot of thought to the general question of functions and responsibilities. I am always bothered by the limits of generalization when dealing with such a heterogeneous collection of organizations and those that constitute the business sector of our economy. The plain fact is that successful businesses exist with a wide variety of organizational patterns, competent managers operate in different ways, and among business leaders we find such a diversity of personality, background, areas of competence, and individual skills that efforts to determine the particular set of capabilities that characterize successful management have met with only limited success. However, notwithstanding these qualms about diversity, we like to think there is something that can be called a science of management. And it is fairly clear that the role of financial managers falls into the three broad areas indicated on the accompanying chart: accountability, control, and planning. In any system of classification, there are areas of overlap and interrelation. The dividing lines here exist because in each of these areas of responsibility the focus and the basic issues are significantly different.

Within these three broad categories it is possible to outline the specific functions in a variety of ways. The particular set of subdivisions that appear on my chart are expressed in terms sufficiently broad to encompass most of the functions that can be generalized; but one would be hard put to defend this listing as exhaustive, and I do not propose to put forth such a claim.

I do propose to explain why I think this way of organizing the problem is pertinent and useful. I shall also direct attention to some of the most pressing problems and put a finger on what I think are the basic issues that lie at the root of these problems.

The Function of Accountability

A primary function of any financial manager is financial reporting to outsiders—accountability. As indicated on the chart, the focus in this area of responsibility is on reporting the position and performance of the firm as an economic entity, to outsiders—owners, creditors, taxing authorities, and the public. In performing this function, the controller is in a somewhat anomalous po-

Oregon Business Review

Vol. XX EUGENE, OREGON, SEPTEMBER 1961 No. 9

BUREAU OF BUSINESS RESEARCH, UNIVERSITY OF OREGON
Wesley C. Ballaine, Director Donald A. Watson, Assistant Director
Catherine Lauris, Editor

Published monthly. Entered as second-class matter, August 10, 1948, at the postoffice at Eugene, Oregon, under the act of August 24, 1912. Persons wishing to receive the *Review* regularly should address requests to the editor. There is no subscription charge.

sition. He wears the hat of management, yet he is responsible for compiling financial data into what is in essence a report of managerial performance. His boss looks over one shoulder, his CPA looks over another, and the shadows of the SEC, the Internal Revenue Service, union officers, and creditors hang over the whole process. Only his wife professes complete indifference to the results of his efforts.

Some controllers may be surprised by the thought that they wear two hats in performing the function of accountability. However, the basic responsibility for exercising professional competence and of making a full disclosure of pertinent information is an objective and factual set of reports that cannot be shifted. At the same time, there is the responsibility to his firm to see that the information that will service his firm's best interests is collected and disseminated to outsiders in a clear understandable fashion. There is an occasional conflict in these two objectives; and every controller worth his salt wrestles with the problem of reconciling his professional responsibility for factual reporting with his natural inclination to shape the data to fit particular ends.

Let me cite some specific examples.

I recently read a report for an investment advisory service on the common stock of Georgia Pacific. The writer went to some lengths to support his contention that the company's earnings were materially understated in its statements, since deductions for depletion on timber cut were, in his opinion, fully offset by the growth of standing timber. (He might also have questioned whether some future benefits were not represented by development costs being written off currently.) The analyst concluded that actual earnings were therefore about twice as large as reported, and the price-earnings ratio about half what it appeared to be. Obviously, financial managers cannot be responsible for all attempts of security analysts to paint an optimistic picture. But if confidence in published financial statements is at a low ebb it is because even sophisticated users of this information are convinced that companies are not reporting the objective facts and that reported data must be manipulated to arrive at results relevant for investment decisions.

Another example. The use of long term leases as a method of financing has increased substantially in recent years. Most companies that have long term leases do not reflect the related property rights and fixed obligations in their position statements. Information concerning leases is sometimes set forth in statement footnotes, but there is little uniformity in the extent of the disclosure. The decision by management to lease rather than own is based on a number of factors. The company may wish to avoid a heavy investment in productive facilities and thus make working capital available for other purposes. Income tax advantages may be a factor in some leasing arrangements. Existing debt covenants may preclude further borrowing. There may be a wish to avoid showing long term debt on the position statement.

Whatever the motivation for leasing, the fact remains that long term leases are in many respects comparable to other forms of long term debt. The lessee acquired a property right and incurs a determinable and material obligation. A failure to record the asset and the discounted amount of the liability distorts the reported financial position of the firm. Financial statements prepared by firms that own and firms that lease property are no longer comparable. Financial managers are not doing a first rate job in factual reporting in this area.

Another example. Many companies report significant items of revenue and expense for tax purposes on a basis different from that followed in accounting records. It is a financial manager's responsibility to see that his firm avails itself of all legal procedures for minimizing its tax cost. But this responsibility does not rightfully carry over into the area of accountability to outsiders, and where differences between good reporting standards and the tax law are significant there are valid reasons for making accounting independent of the tax law. Furthermore, financial reporting would be improved and outsiders better informed were firms to disclose the major differences between reported and taxable income. Firms that chose a declining pattern of depreciation charges for tax purposes and report on the basis of straight line depreciation should disclose the difference in depreciation. The concept of capital gains does not affect accounting income, but it has a material bearing on income tax liabilities. Yet the reader of financial statements finds no information that will aid him in assessing the effect of capital gains on income tax provisions. The operating loss carryover provision of the tax law make assets out of the future tax reduction promised by a carryover of an operating loss, yet seldom, if ever, is this effect reported in the *loss* year.

Another example. Stock options have become a significant means of compensating executives in a way that minimizes tax impact and provides considerable incentive for a good performance. Because the benefit to executives is significant, it is clear that the cost of such options to the firms is also a matter of considerable interest. Yet one may look in vain in the financial statements of most companies for information that will enable him to estimate the cost of such options to the corporation in terms of the difference between option price and market price at the date the option is exercised.

Aside from the problem of fairly reporting the financial facts, the thoroughness of reporting, the steps taken by financial managers to see that complete information gets into the right hands can have a material impact on the welfare of a company. Two examples come to mind for brief mention. Forty years ago Clevite Corporation was a 19-man firm in Cleveland making bearings. Early in their history they took a strong position on the value of public reporting. They gave a great deal of attention to their annual reports, and mailed them out freely, not only upon request, but sent them of their own volition to parties having a potential interest. In my opinion, this factor plays an important part in the fact that they are now one of the 500 largest industrial companies in America, their stock now sells at

a very handsome price-earnings ratio, and the company has good access to the capital markets. In our own area, Potlatch Industries has done a generally excellent and steadily improving job of reporting for a company of their size. We have used their financial statements as models in the financial analysis portion of our executive development program, and their reports have played an important role in the increasing recognition given in recent years to the firm as a comer in the lumber industry. Thorough and aggressive reporting of your company position, particularly for those companies not closely held, is an aspect of accountability that can have a favorable impact on a company's financial welfare.

Operational Control

Now let us turn to the second major area of responsibility—operational control. The distinction between planning and control in managerial science is not always recognized. Some people regard planning and control as the inseparable Siamese twins of management. It is obvious that one cannot exist without the other, but there is a basic and important distinction between the planning and control functions. Planning is fundamentally a matter of choosing among alternative courses of action—of deciding what to do. Control, on the other hand, is the entire process of seeing that plans are carried out.

To illustrate. The problem of inventory control is to balance the cost-minimizing wish for minimum average inventories against the cost advantages of stable production and the revenue-maximizing wish to have complete stocks on hand to meet customer demands. The planning phase of the analysis is to set minimum and maximum order points and to establish optimal order or production quantities. Once the alternatives have been studied and an optimal plan established, the control function is to carry it out and report on performance against the plan.

The aspect of control that is peculiarly the function of the financial manager is to measure plans against performance and to report the results of this measurement to operational managers, together with an analysis of the reasons for variations, and, where possible, recommendations for positive and remedial action.

In thinking about the control problem, accountants have a natural tendency to concentrate on various cost allocation systems and techniques. In the process, it is easy to lose sight of the fact that organizations are composed of human beings and that the control process is largely a matter of inducing people in an organization to do certain things and refrain from doing others. We do not really control products, or costs, or volume; we control the actions of people who are responsible for generating sales, or making products, or incurring costs. Professor Anthony, of Harvard, makes this point:

> Although the management control process is often compared with mechanical or electrical control devices, such as the thermostat, such an analogy is apt to be quite misleading. A thermostat reacts to stimuli in a definite, predictable fashion. When the temperature goes down to a certain point, the furnace is turned on; when the temperature rises to a certain point the furnace is shut off. Human beings, on the other hand, do not behave so predictably; human reactions to a stimulus are much more complicated, and human control systems cannot be so easily or so precisely designed as mechanical or electrical ones. If, for example, my wife tells me the room is too warm, my reaction may be (and after years of training, usually is) to open a window or to take some other steps to cool it; but occasionally, I may procrastinate and do nothing, or I may even argue that the room is not too warm anyway. Thermostats do not argue, they do not procrastinate, they do not resent being told what to do, they do not do what they think best. In short, they are not human.

The point is that management control systems involve people and the reactions of people, and we cannot examine the problem of developing cost information for control purposes without taking this into account.

It is also true that the basic objectives to be met in the control area are quite different than those in the realm of accountability. In terms of reports to outsiders, there is considerable point to the heated arguments over the relative merits of various methods of cost allocation, and attempts to test various ways of measuring revenues and costs against standards of objectivity, fairness, and acceptability. But these are not limiting factors when we are trying to develop cost information internally for control purposes. Accounting information serves the control function by contributing to three basic objectives:

1. to communicate plans to operating personnel
2. to motivate persons in the organization to act in the best interests of the firm.
3. to measure the performance of operating personnel in terms of what management expects them to do.

The primary issues, then, are: How will internal accounting information be used in accomplishing these three purposes. Since there is an economic factor in data collection we must also consider whether the cost of developing the data on a basis distinct from that necessary to meet the requirements of accountability is worth the benefits to be gained.

Defining cost responsibilities. An early step in designing a control system is to clearly define cost or profit responsi-

THE UNIVERSITY AND THE BUSINESS COMMUNITY

Cameron Hawley, who has three popular novels to his credit, will address Portland business men at luncheon, January 24, 1962. This will mark the fourth annual one-day conference for the business community of Portland which the School of Business Administration sponsors each year.

Mr. Hawley's novels, *Executive Suite, Cash McCall,* and *The Lincoln Lords,* concern the problems of contemporary Americans in the business world. Their vivid authenticity stems in part from Mr. Hawley's successful administrative career with the Armstrong Cork Company. During the 25 years of his association there, his responsibilities ranged from merchandising to financial analysis, and from sales promotion to the direction of research. His writing career began when he was twelve, with a small South Dakota newspaper and was pursued along with his business career until 1951. The conflicting demands of two successful careers forced a choice between them at that time. All three of his best-selling books have been written since leaving the business world.

Mr. Hawley now writes frequently in the category of nonfiction. His great interest is foreign affairs and his articles on this and other subjects appear in the *Saturday Evening Post, Life,* and *Harper's.*

The papers presented at the 1961 conference have been published under the title, *Business Developments 1961.* Copies are available upon request.

bilities within the organization. The idea of cost centers is relatively old. They are a device for collecting costs that are charged to products passing through the center. Cost centers are also *responsibility centers* if one person is responsible for performance. There is a crucial difference in viewpoint, however, in the idea of a responsibility center. The costs are charged to a department for product costing purposes and are not necessarily the relevant costs for measuring responsibility and performance. For product costing, it is appropriate to charge a cost center with costs incurred in a department and a fair share of other overhead costs incurred outside the department. For control purposes, the arguments rage whether these allocated costs are relevant and the issue of controllable versus noncontrollable costs deserves all the attention it has been receiving in recent years.

Setting standards of performance. Once responsibility centers have been established, we are faced with the problem of setting standards of performance. The budget is a communication device that tells each unit in the organization something about what management expects it to do during the budget period. Plans and objectives are also communicated by cost standards, and cost allocation procedures. It is in the area of setting standards that the question of motivation becomes crucial. I am indebted once more to Professor Anthony for an illustration of this point which I find hard to improve upon.

The maintenance function in a plant is to keep buildings and equipment in good operating condition. This responsibility is often hard to tie down because it is split. The maintenance department, which incurs costs in making repairs and maintaining plant, is partially responsible; the operating foremen, who can influence the amount of maintenance required by the care they give equipment, are also responsible.

There are a number of ways in which maintenance costs can be charged to responsibility centers and in which standards can be set; each sends a different message to the foreman and maintenance manager about how they should view their responsibility. A few examples will illustrate the point:

Method 1. Do not charge any maintenance costs to the operating departments. This tells the maintenance department that they are responsible for the condition of equipment and the cost of repairs. It also tells the operating foreman that he is not responsible for maintenance costs and motivates him to request whatever maintenance work he thinks should be done.

Method 2. Allocate maintenance costs to operating departments on the basis of direct labor cost on hours. The message here is that maintenance costs are expected to vary proportionally with plant activity. The operating foreman has no particular responsibility for maintenance work, but he is charged with his "fair" share. He cannot influence this share very much by the amount of maintenance work he demands, and he is motivated to demand at least a reasonable share.

Method 3. Charge operating departments for each maintenance job at a standard job price. This tells the foreman that he is responsible for situations that create the need for maintenance, but he need not be concerned with the efficiency with which maintenance men work. This is the responsibility of the maintenance department.

Method 4. Charge each department for maintenance work at an hourly rate for each hour spent by maintenance personnel. Now the foreman is motivated to control both the need for maintenance work and the time taken by maintenance people to do the work. He might even ask for permission to hire outside maintenance people if he finds they can do the work less expensively.

Anthony points out that none of these methods (or others you may think of) are necessarily better than others. The choice depends on what management wants to accomplish and where they want to center responsibility. The problem is to decide on the direction and intensity of the motivation desired, and to select a standard and method of cost allocation that influences the foremen to act in this manner. This becomes the central underlying issue in setting cost standards for control purposes.

Appraising performance. Any attempt to measure performance for control purposes should focus on strategic indicators of quality performance. This is not solely a matter of watching for exceptions, but for strategic exceptions; and it is the responsibility of the controller to help management select these strategic factors, which are not always related to cost reports. An airline manager, for example, may watch on-time performance as a first rough measure of quality of operations, and if this turns out to be a valid indicator it should be incorporated in the control system.

Just a word about the three items listed on the chart under appraising performance. There are two important issues at stake in discussing variance analysis. The first is to grasp the idea that the variance itself is not a control. Costs are not controlled by compiling data about them; control is exercised by management when it takes steps to bring costs into line. The second is related to the first. Cost variances are complex, as one who has tried to teach the subject well knows, and we are thus torn between a desire for a sophisticated variance analysis that sharpens the meaning of the variances, and the desire to keep variance reports simple so that operating personnel can understand them. There is no solution to this problem, but I think sometimes the pleas for simplicity get more attention than they deserve. Nothing can destroy confidence in variance analysis for control purposes faster than variances that turn out to be meaningless or to mean something different than what they purport to show.

THE UNIVERSITY AND THE BUSINESS COMMUNITY

A recent publication of the School of Business Administration is now ready for distribution. Entitled *The Study of Administration*, the book was written by Professors E. S. Wengert, D. S. Harwood, Lucian Marquis, and Keith Goldhammer, and is a partial result of an experimental class offered to students preparing for administrative work in the fields of education, government, or business. A limited number of copies are available upon request. Both the book and class for which it was prepared were financed by a grant from the Ford Foundation.

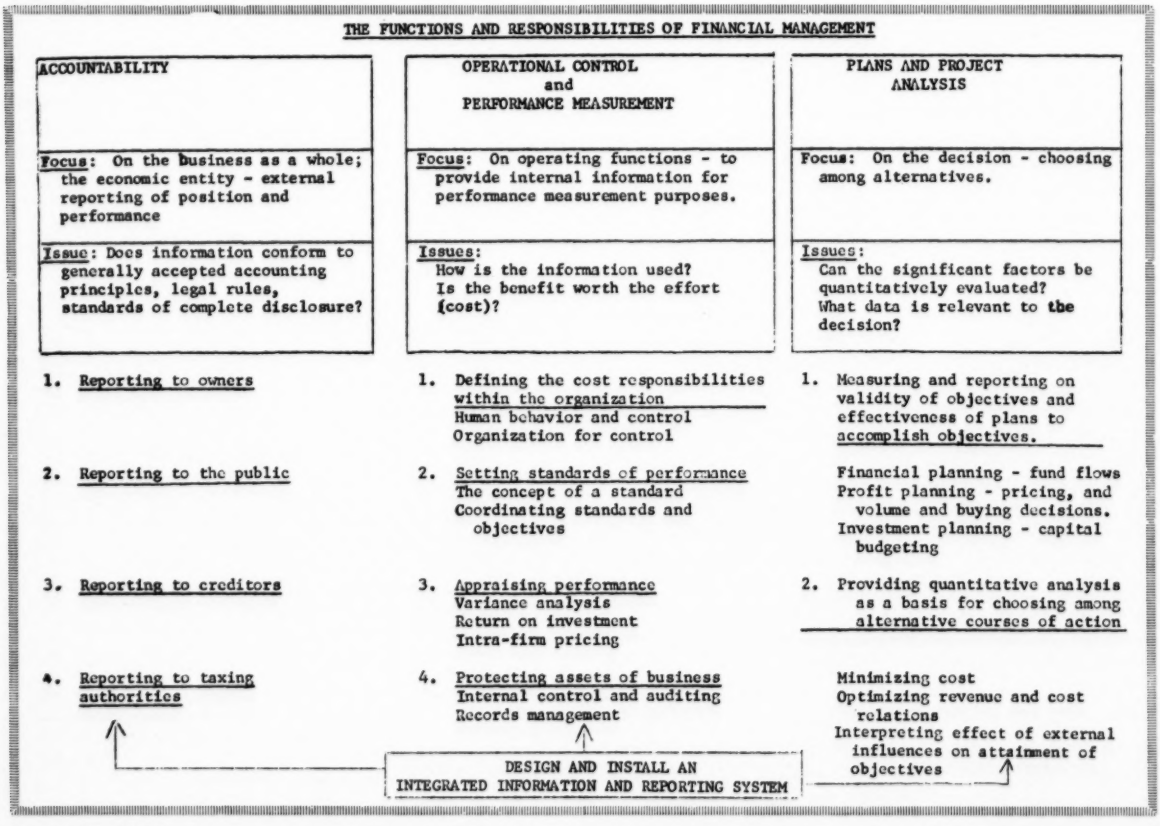
A promising approach to variance analysis is the idea of setting variance limits on the basis of probabilities, and reporting only those variances that fall outside a range of probable normal variations. Anything within the range of chance variations is not reported or not highlighted in the report.

Return on investment is the backbone of performance measurement; and with all its faults is still the best test that management has of success in meeting its profit objectives. Furthermore, by constantly relating income to amounts invested we can keep the control emphasis on the right target and avoid the myopia that comes from too much concentration on volume, or on margin of profit on sales.

Control of return on investment by departments or divisions requires that responsibility centers be held accountable for both revenues and costs—i.e., that they be profit centers. In financial accounting, revenue is recognized only when realized. In managerial accounting, however, valid purposes may be served by defining revenue as the value of the output of a profit center. Producing departments may sell production to sales departments, and service departments sell services to receiving departments. The idea of intra-company transfer pricing is beautiful in its theoretical simplicity and control potential; and frightening in its practical difficulties. The value of goods and services transferred within a company are not established by a market transaction, although "yardstick market" prices are often available. But then the question arises whether yardstick prices should be tailored to reflect lower selling costs, nonexistent bad debt losses, etc. Furthermore, when yardstick market prices are not available outside, and we attempt to build negotiated prices into the structure, we run into problems in assuring that the departments involved negotiate from relatively equal strength.

Internal profit control systems in which departments deal with each other as they would outside entities, each in pursuit of its own optimum, have not always been successful. The potential control benefits to be obtained from profit centers, however, is great. The idea is worth careful study, and should not be abandoned simply because there are administrative headaches.

Internal auditors have a right to quarrel with the way in which I have limited internal control and auditing in the 4th subdivision on the chart under operational control. In a very real sense, the terms internal control and internal auditing are broad enough to encompass the entire operational control area. I have used them, however, to describe the important but narrower function of protecting the assets of the business. If you have read the recent sociological study, *The White Collar Thief*, and similar books, you will recognize that the problem of establishing adequate controls over all assets is a matter of growing importance and concern. In addition to this aspect, the protection function involves esablishing detailed records controlling both circulating assets and plant and equipment. The subject of records management itself is a troublesome one that does not often receive the attention it deserves.


THE FUNCTIONS AND RESPONSIBILITIES OF FINANCIAL MANAGEMENT
ACCOUNTABILITY
Focus: On the business as a whole; the economic entity - external reporting of position and performance
Issue: Does information conform to generally accepted accounting principles, legal rules, standards of complete disclosure?
1. Reporting to owners
2. Reporting to the public
3. Reporting to creditors
4. Reporting to taxing authorities
OPERATIONAL CONTROL and PERFORMANCE MEASUREMENT
Focus: On operating functions - to provide internal information for performance measurement purposes.
Issues: How is the information used? Is the benefit worth the effort (cost)?
1. Defining the cost responsibilities within the organization
Human behavior and control
Organization for control
2. Setting standards of performance
The concept of a standard
Coordinating standards and objectives
3. Appraising performance
Variance analysis
Return on investment
Intra-firm pricing
4. Protecting assets of business
Internal control and auditing
Records management
PLANS AND PROJECT ANALYSIS
Focus: On the decision - choosing among alternatives.
Issues: Can the significant factors be quantitatively evaluated? What data is relevant to the decision?
1. Measuring and reporting on validity of objectives and effectiveness of plans to accomplish objectives.
Financial planning - fund flows
Profit planning - pricing, and volume and buying decisions.
Investment planning - capital budgeting
2. Providing quantitative analysis as a basis for choosing among alternative courses of action
Minimizing cost
Optimizing revenue and cost relations
Interpreting effect of external influences on attainment of objectives
DESIGN AND INSTALL AN INTEGRATED INFORMATION AND REPORTING SYSTEM

Plans and Project Analysis

Finally we come to the planning function. This is probably the area of financial management in which the greatest strides have been and are being made in recent years. Operations research and the applications of a wide variety of fairly powerful quantitative tools of analysis to the planning function cannot be ignored by a controller who is on his toes.

We are inclined to think of planning as synonymous with budgeting—because budgets are the planning tools most familiar to accountants. A budget, however, is basically a means of communicating plans to personnel, and as such it is the end product of planning. The hard core of planning is choosing, and the focus of planning is the decision. A planning problem arises when an alternative course of action is discovered.

A good set of plans contributes in some positive way to the accomplishment of business objectives. Thus, plans and objectives are inseparable. The financial manager's responsibility for planning lies primarily in developing quantitative measure of the effectiveness of plans in accomplishing objectives.

Financial planning. The least complex area of planning is probably in the area of financial requirements. Our tools for fund flow analysis are fairly sharp. The feasible alternative means of raising funds are fewer than one might imagine if he glanced at a list of financing devices. The primary problem of the financial manager is to keep his fund flow analysis a jump or two ahead of operations and to anticipate the financial needs of his company before they arise. Traditionally, fund flow analysis has been made in terms of working capital—which is usually viewed as a fund of relatively liquid resources flowing in and out of the business. In recent years, we have seen a growing emphasis of fund analysis in terms of the fund of cash and marketable securities. Some accountants have pushed hard for a concept of funds defined as quick assets less current liabilities—and I have seen this kind of fund flow analysis appearing in a few annual reports recently. Which concept of funds is appropriate in financial planning depends to a large degree on the flexibility of investment in such current assets as receivables and inventories. Financial managers might well do more experimenting with their measures and reports of funds flows, and study which concept is most appropriate to their circumstances.

Profit planning. The area of planning that has received the greatest attention over a relatively long period of time is profit planning. Decisions on pricing, volume of output, optimal purchasing policies have been studied from every conceivable angle. We have learned that here are two equally important blades to the scissors that cut an adequate rate of return out of the economy: (1) the volume generated by $1 of productive investment; and (2) the rate of profit per dollar of sales volume. Good profit planning, therefore, requires keeping an eye on asset turnover as well as profit margins.

It is a mistake to assume that volume increases will cure the profit problems of any firm. Increases in volume will bring good results only when a company's products are volume sensitive. By volume-sensitive we mean those instances where earnings are so sensitive to changes in volume that sizable reductions in price can be made profitably if we can obtain modest volume increases to offset their effect.

By price-sensitive products we mean business where earnings are so sensitive to changes in price that even a sizable increase in volume will not profitably offset even a minor decrease in price.

In general, price-sensitive products are those with high variable costs and low fixed costs; and volume-sensitive products are those with high fixed costs and low variable costs. Upgrading the product mix by studying volume and price sensitivity is one of the most important areas in profit planning.

Capital budgeting. One of the most difficult areas of planning is that of investment decisions. We are seeing a strong upsurge of interest in this problem as evidenced by a great deal of literature in recent years on the principles of capital budgeting. Not withstanding the development of investment theory, many companies are guilty of one or more of the following faulty practices in making investment decisions:

1. They tend to leave out of investment analysis the effect of variables that cannot safely be ignored. For example, the common payoff period requirements completely ignores the economic life of an investment and project earnings subsequent to the payoff period.
2. Certain key facts or conditions are omitted from the analysis. For example, simple averages of investment and earnings are often used—yet most investments are made in the face of the prospect of a declining curve of net receipts and a significant cost of invested capital.
3. Companies often misstate and solve the wrong problem. Deciding upon and getting the data that is relevant to the investment decision is not a job that lends

THE UNIVERSITY AND THE BUSINESS COMMUNITY

Richard W. Lindholm, Dean of the School of Business Administration, and Wesley C. Ballaine, Director of the Bureau of Business Research, believe that it is highly desirable for the Bureau to receive the benefit of continuing counsel and advice from a group of men who are leaders in both business management and the environment in which business operates.

To this end, University of Oregon President Arthur S. Flemming has appointed a committee to advise the Bureau in the development of a progressive research program in the area of business management and the collection of economic data for use in business decisions.

Current members of this committee are: T. E. Bolger, vice president and general manager for Pacific Telephone Northwest, Portland; Harold Cake, vice president of Equitable Savings & Loan, Portland; Thomas W. Delzell, chairman of the board, Portland General Electric; Charles F. Luce, administrator, Bonneville Power, Portland; S. H. Mallicoat, director, State Department of Planning and Development, Portland; George B. Martin, assistant superintendent of schools, Salem; Tom Scanlon, educational director, AFL-CIO, Portland; Edgar Smith, Portland; Ray Vester, vice president of Capitol Finance Corporation, Portland.

itself to rules of thumb. For example, it is surprisingly common in equipment replacement analysis to find firms comparing two cost streams as if the remaining life were the same; often the life of the new asset. And some fairly sophisticated controllers still fall into the trap of assuming that unamortized cost of an old asset is a relevant factor in an investment decision.

4. Not enough consideration is given to the cost of capital. Many firms do not have any very clear idea of their cost of capital. Firms that know their cost of capital often do not use it properly in choosing among potential capital investments.

In a great many instances, business decisions are based on intuition; no systematic attempt is made to define, measure, and evaluate the advantages and disadvantages of alternative actions. This may be because the decision maker is careless or unaware of analytical approaches; sometimes it is because the problem does not lend itself to a systematic weighing of alternatives. There is not much point in making calculations when available information is sketchy, inaccurate, or irrelevant; and no amount of analysis will help much when attitudes or emotions of individuals are the major factors in the problem.

There are a significant number of situations, however, where it is possible to reduce some of the consequences of alternative actions to a quantitative basis in order to evaluate these alternatives in terms of measurable objectives. It is in this area that the financial manager performs perhaps his most valuable function. We may assume that if alternative courses of action are available a business should select the one that is likely to lead to the highest return on investment, and data derived from accounting records is the primary base for decision analysis.

The basic approach to alternative choice problems may be outlined quite simply: 1. define the problem. 2. define the most likely alternative solutions 3. measure the effect of those consequences of each alternative that can be expressed in quantitative terms 4. evaluate those consequences that cannot be expressed quantitatively and weigh them against each other and against quantitative consequences 5. make the decision.

Applying this neat outline in practice is both an art and a science, and one may spend a lifetime acquiring the necessary tools of analysis and skill required.

One of the phases of decision analysis that accountants need to give particular attention is the necessity of studying the influence of external influences on the attainment of objectives. Accountants feel quite at home in talking about optimizing profits or in dealing with cost minimization when they can get their fingers on historical data. They are less comfortable in making forecasts of what will happen, in dealing with probabilistic determinations of future events, in talking about expected values. A large part of the fate of any business is in the hands of such external forces as its customers, the market, interest rates, buying behavior, its competitors' actions. The financial manager who is not willing to become knowledgeable about such factors so that he may grapple intelligently with the influence of such factors on the consequences of alternative actions, is relegating himself to a lesser role on the managerial team.

Summary

All this adds up to a tall order. Perhaps the man who performs all or a substantial portion of these functions exists only in Utopia. And I have not mentioned the toughest responsibility of all—to sell operating management on the value and usefulness of quantitative information and analysis. Many operating managers have gotten along by operating by "the seat of their pants"—in fact, a fair proportion of reasonably correct decisions may often be made in this manner by a skilled and intuitive administrator. Thus, the line managers in this world are not standing around begging for accounting data and quantitative analysis; they often have to be convinced that the nasty medicine is good for them.

In 1908, W. M. Cole first discussed the virtue of what he called a "where got where gone statement"—the forerunner of our present fund flow analysis. In 1925, an article appeared in the accounting journals saying that this kind of statement sounded good, but it was hopelessly complex and one could never expect management to understand it. It wasn't until after World War II that the fund statement and fund flow analysis became an almost universal part of internal reporting and an important basis for financial planning. Thus, it took about 50 years for accountants to sell, teach, and explain fund flow analysis to management and convince them that this was valuable information. This has been about par for the course—most of the tools we use today have their antecedents an embarrasingly far distance back in history. Selling his services is still perhaps the toughest responsibility of all for financial managers.

This outline is designed to serve as a basis for planning a program of study and discussion over the next several years. If I have laid out a tough, challenging, and useful course, I shall be most pleased; if after a few years, controllers cannot rewrite this chart and make substantial improvements, I shall be dumbfounded. For in examining these functions and responsibilities in greater detail, the professional man will inevitably find some fuzzy areas, some boundaries that need redefining, some obvious clarifications. Furthermore, financial management is not less dynamic than any other area of business. If new problems, new ways of looking at old problems and new responsibilities do not show up in the next few years, we shall have witnessed a miracle.

THE UNIVERSITY AND THE BUSINESS COMMUNITY

Supervisory employees in the business community spent five days in September at a special on-campus seminar studying the latest knowledge and research in the field of management. The 23 administrators in attendance represented the following companies: Boeing Company, Crown Zellerbach Corporation, Davidson Baking Company, Electro-Scientific Industries of Portland, Eugene Water & Electric Board, Giustina Bros. Lumber Company, Hult Lumber Company, International Paper Company, Snellstrom Lumber Company, State Dept. of Motor Vehicles, U. S. Plywood Corporation, and Weyerhaeuser Co.

The program was one of an annual series prepared by the School of Business Administration of the University of Oregon and arranged for by the General Extension Division of the Oregon State System of Higher Education.

Which is Safer, Being Governor or Being President?

By MARK R. GREENE
Head of Department of Management, Production, and Marketing, University of Oregon

Is holding a high political office a "safe" occupation? Does it shorten one's average life expectancy? If so, is there any difference whether one is a president or a governor? The remarks which follow are not designed to answer this question, but to stimulate some thought on the subject.

At the present time, the United States has living three former presidents, the first time in history that so many former chief executives have been living at the time of the inauguration of a new president. Herbert Hoover—87, Harry Truman—77, and Dwight Eisenhower—71, had a combined expectation of life of 46 years after the dates they took office, according to life insurance mortality tables in use at the time.[1] They have already outlived this expectancy by ten years. Together, they have survived a total of 56 years since their inauguration, and from all appearances they are still "going strong." From this observation, it might appear that being president under today's conditions isn't the "killing experience" that it has commonly been billed in times past.

Currently, Oregon has four former governors living, whose combined expectation of life after their first inauguration was 103 years. These men, Charles A. Sprague—73, John H. Hall—72, Elmo Smith—51, and Robert Holmes—52, have lived a total of 65 years since their inauguration.[2] It is, therefore, too early to tell whether or not an experience as Governor of Oregon is more or less "telling" than it is to be President of the United States. A review of some historical experience on past governors of Oregon as compared to past presidents of the United States, however, suggests, as one might suspect, that if holding a high political office has any effect on mortality rates, holding the governorship of Oregon might be a healthier occupation than holding the presidency of the United States.

TABLE 1

LONGEVITY OF DECEASED AMERICAN PRESIDENTS

President	*Age at Inauguration*	*Expected Years of Life at Inauguration*	*Actual Years of Life After Inauguration*
Abraham Lincoln	52	18	4
Andrew Johnson	56	15	10
U. S. Grant	46	21	16
R. B. Hayes	54	17	16
J. A. Garfield	49	20	16
C. A. Arthur	50	19	5
Grover Cleveland	47	23	23
Benjamin Harrison	55	18	12
William McKinley	54	18	5
Theodore Roosevelt	42	26	17
William H. Taft	51	20	21
Woodrow Wilson	56	16	11
Warren G. Harding	55	18	2
Calvin Coolidge	51	21	9
Franklin D. Roosevelt	51	21	12
Totals	769	291	179
Averages*	51	19	12

* All figures rounded to nearest whole number.

Table 1 presents the record of deceased American presidents since Abraham Lincoln, and Table 2 shows the record for deceased Oregon governors since the time of John Whiteaker, the first Oregon governor under the United States government.[3] Whiteaker took office in 1859, about a year before Lincoln became President.

United States presidents during the past 100 years failed, in general, to live out their life expectancy by an average of about seven years. Oregon governors have fared much better, having, on the average, just about lived out their normal life expectancy after the date of inauguration. Interestingly enough, the average age of both United States presidents and Oregon governors was about the same, 51 at the time of inauguration. The average tenure of the governors, however, was somewhat shorter than the tenure of the presidents. Governors of Oregon served an average of 3.9 years, and United States presidents averaged 4.7 years.

One might be tempted to conclude that, on the basis of these figures, it is safer to be Governor of Oregon than it is to be President of the United States. Such a conclusion is,

TABLE 2

LONGEVITY OF DECEASED GOVERNORS OF OREGON

Governor	*Dates of Governorship*	*Age at Inauguration*	*Expected Years of Life at Inauguration**	*Years of Life After Inauguration**
Whiteaker, John	1859-1862	39	29	43
Gibbs, A. C.	1862-1866	37	30	24
Woods, George L.	1866-1870	34	33	24
Grover, LaFayette F.	1870-1877	47	23	41
Chadwick, Stephen F.	1877-1878	52	19	18
Thayer, Wm. Wallace	1878-1882	51	20	21
Moody, Zenas Ferry	1882-1887	50	21	35
Pennoyer, Sylvester	1887-1895	56	17	15
Lord, William Paine	1895-1899	56	17	16
Geer, T. T.	1899-1903	48	22	25
Chamberlain, Geo. E.	1903-1909	49	22	25
Benson, Frank W.	1909-1910	51	20	2
Bowerman, Jay	1910-1911	34	33	47
West, Oswald D.	1911-1915	38	30	49
Withycombe, James	1915-1919	61	29	4
Olcott, Ben Wilson	1919-1923	47	23	33
Pierce, Walter M.	1923-1927	62	13	31
Patterson, Isaac Lee	1927-1929	69	9	2
Norblad, Albin W. Sr.	1929-1931	48	23	31
Meier, Julius L.	1931-1935	57	16	6
Martin, Chas. Henry	1935-1939	72	8	11
Snell, Earl Wilcox	1943-1947	48	27	4
McKay, Douglas	1949-1952	56	20	10
Patterson, Paul L.	1952-1956	52	23	4
Totals		1,214	527	521
Averages		51	22	22

* Rounded to nearest whole year life expectancy based on American Experience Mortality Table for years prior to 1927, C.S.O., 1941 Mortality Table for years 1927-1942, and C.S.O., 1948 Mortality Table for years after 1942.

The Pacific Oil Conference, a group of independent distributors in the three Pacific Coast states, held their 1961 meeting at the University of Oregon under the sponsorship of the University. There were welcoming words from President A. S. Flemming and Dean R. W. Lindholm. In addition, Professors T. G. Johnson and W. C. Ballaine participated in the program.

The Oregon Society of Certified Public Accountants held a conference devoted to budgeting on the campus during September. The discussion leaders were from the staff of the Accounting Department of the School of Business Administration.

of course, impossible to reach. There are far too few individuals concerned in the available evidence in order to draw valid comparisons for statistical purposes. Even though one may not correctly draw sound conclusions, it may be comforting to the political aspirants of Oregon to know that no Oregon governor has ever been assassinated, and most of them have lived to ripe old ages. On the other hand, three United States presidents have been assassinated (Lincoln, Garfield, and McKinley), and presidents deceased since Lincoln's time have not lived out their normal years.

[1] Specifically, the Commissioner's Standard Ordinary, 1941 Mortality Table.

[2] Governor Sprague served from 1939 to 1943; Governor Hall, 1947-1949; Governor Smith, 1956-1957; and Governor Holmes, 1957-1959.

[3] Oregon had seven governors from 1845 to 1859 under the Provisional and Territorial Governments: George Abernethy, Joseph Lane, Kintzing Prichette, John P. Gaines, George L. Curry, John W. Davis, and Benjamin F. Harding.

"I agree with the Council (of Economic Advisers) that we need to enlarge the national effort devoted to scientific research and basic education, but I feel that we need also to become far more efficient than we have been in conducting our educational enterprises. We need to hasten adaptation to changing technology by undertaking extensive training programs for unskilled workers in our individual communities, as well as retraining programs for industrial workers whose skills have become obsolete. It also would be constructive to stimulate the smaller firms, which are counted in the millions, to practice greater efficiency. With proper organization, our colleges of business administration should be able to render much the same kind of assistance to small businesses that our agricultural colleges have over many years rendered to farmers." (Arthur S. Burns, Professor of Economics at Columbia University, President of the National Bureau of Economic Research, and former Chairman of the Council of Economic Advisers, writing for the *Morgan Guaranty Survey*, Aug. 1961, p. 11.)

OREGON STATISTICAL REVIEW

Lumber. These figures were reported by the West Coast Lumbermen's Association. They cover the Douglas fir area of the Pacific Northwest and are in thousands of feet, board measure.

	Aug. 1961	*July 1961*	*Aug. 1960*
Average weekly production	154.526	124,954	167,776
Average weekly orders	147,400	141,337	159,108
Unfilled orders, end of month	466,495	499,058	485,955
Lumber inventory, end of month	1,095,724	1,095,507	1,128,234

Department store sales. Figures on department store sales are compiled by the Federal Reserve Bank of San Francisco for Oregon, the Portland and Eugene areas, and Salem. The data are released for Portland each week and once a month for all three cities and the state as a whole.

The most recent Portland area data are for the week ending September 9, 1961, when sales were 14 per cent above those of the corresponding week in 1960.

Sales for the month of July and for the first seven months of 1961 have been compared with those for the corresponding periods one year earlier. Percentage changes are shown in the following table.

	July 1961	*Jan. 1, 1961 to July 31, 1961*
Oregon	+ 1	+ 1
Portland area	+ 3	+ 1
Eugene area	+ 2	+ 2
Salem	— 4	0

Employment. Information on employment in Oregon is reported each month by the State Department of Employment in Salem. The latest figures follow, exclusive of agricultural employment.

	Aug. 1961	*July 1961*	*Aug. 1960*
Lumber and wood products	74,100	73,200	77,000
Food and kindred products	30,500	22,200	30,300
Other manufacturing	51,900	51,600	53,100
Total manufacturing	156,500	147,000	160,400
Contract construction	23,300	24,700	30,800
Retail and wholesale trade	115,700	114,700	117,000
Government	97,000	95,300	91,600
Other nonmanufacturing	135,000	135,100	31,300
Total manufacturing	371,000	369,800	365,300
Total wage and salary employment	527,500	516,800	525,700
Per cent of unemployment	4.4	5.1	3.9

Average weekly earnings of production workers in manufacturing industries in Oregon provide timely information on current trends of labor costs as well as rough measures of average income available for purchasing goods and services. Both aspects of this information make the figures valuable for consolidation with other data in evaluating the current business situation. Data below are supplied by the Oregon State Department of Employment.

	1961	*1960*
Jan.	$ 97.79	$ 95.72
Feb.	95.52	96.78
Mar.	97.96	96.47
Apr.	101.83	98.57
May	101.69	98.79
June	100.59	96.70
July	102.56	98.02
Aug.	101.63	97.93

Index of man hours in manufacturing. A reliable index of change in manufacturing activity is the man hours of industrial production workers. The index is computed by the Bureau of Business Research from data supplied by the Oregon State Department of Employment (1951=100). Figures apply only to personnel engaged in direct manufacturing; sales, office, and general administrative employees are excluded. No adjustment for seasonal variation has been made. The most recent reading for Oregon is for August 1961.

	1961	*1960*
Jan.	74.1	82.9
Feb.	71.4	84.3
Mar.	74.8	85.3
Apr.	81.5	87.9
May	84.4	89.4
June	93.1	94.6
July	93.0	94.1
Aug.	103.2	103.5

Business failures. The Dun and Bradstreet series on commercial failures is considered an indicator of business health. The figures for Oregon follow.

	1961		*1960*	
	Number	*Liabilities*	*Number*	*Liabilities*
Jan.	21	$ 701,000	41	$ 590,000
Feb.	50	2,454,000	45	1,229,000
Mar.	35	2,403,000	46	1,414,000
Apr.	40	907,000	49	995,000
May	53	1,406,000	38	1,404,000
June	39	734,000	50	1,295,000
July	43	1,105,000	27	378,000
Aug.	53	1,334,000	64	1,746,000

Electric energy. The Public Utility Commissioner of Oregon reports that during July 1961 the total kilowatt hours of electricity sold by privately owned electric utilities in Oregon was almost 5 per cent above that of July 1960.

Total sales for the twelve month period ending 31 July 1961 increased 3 per cent above sales for the same period of time ending one year earlier.

Life insurance sales. The Life Insurance Agency Management Association reports that for July 1961 sales of ordinary life insurance in Oregon were 5 per cent higher ($1,987,000) than for the previous month. There was only slight increase over sales for the same month one year earlier.

Total national sales of ordinary life insurance for the twelve month period ending July 1961 have increased 2 per cent compared with sales for the same period ending one year earlier.

Advertising linage. The Oregon Newspaper Publishers Association reports that for the month of August 1961 there were 656,860 column inches of local retail advertising in 20 daily newspapers in Oregon. This is a decrease of 5 per cent from one year earlier.

OREGON STATISTICAL REVIEW

BANK DEBITS

Bank debits represent the dollar value of checks drawn against the deposit accounts of individuals and business firms. Bank debits are considered good indicators of current activity. But their value for this purpose can be impaired if they include large checks used to transfer funds for the purchase of certain kinds of capital assets that are not "business activity". There are more banks now reporting than were one year ago and the statistics are more complete; but for that reason 1961 data may not be strictly comparable with 1960 data. This month the Bureau of Business Research collected data on bank debits from 230 banks and branch banks.

	Number of banks reporting	*Debits Aug. 1961*	*Debits July 1961*	*Debits Aug. 1960*	*Percentage change Aug. 1961 compared with July '61*	*Aug. '60*
Oregon	230	$2,215,401,357	$2,012,377,699	$2,259,220,380	+10.0	— 1.9
Portland area (Clackamas, Columbia, Multnomah, Washington counties)	79	1,338,524,766	1,248,394,294	1,437,346,048	+ 7.2	— 6.9
Mid-Willamette Valley (Benton, Linn, Marion, Polk, Yamhill counties)	43	292,186,283	240,259,512	260,123,644	+21.6	+12.3
North Oregon Coast (Clatsop, Lincoln, Tillamook counties)	12	43,001,269	38,100,428	40,605,016	+12.3	+ 5.9
West Central Oregon (Coos, Douglas, Lane counties)	31	235,068,895	206,087,646	229,920,875	+14.0	+ 2.2
Southwestern Oregon (Curry, Jackson, Josephine counties)	15	107,197,866	97,018,529	100,893,857	+11.0	+ 6.2
Upper Columbia River (Gilliam, Hood River, Sherman, Wasco, Wheeler counties)	10	30,914,749	29,197,964	28,722,353	+ 5.8	+ 7.6
Pendleton area (Morrow, Umatilla counties)	11	41,153,779	36,936,959	47,832,136	+11.4	—14.0
Central Oregon (Crook, Deschutes, Jefferson counties)	6	32,775,906	30,358,980	28,941,594	+ 7.9	+13.2
Klamath Falls area (Klamath, Lake counties)	8	36,924,268	36,162,029	35,036,572	+ 2.1	+ 5.3
Baker, LaGrande area (Baker, Grant, Union, Wallowa counties)	10	30,835,430	24,743,097	26,854,046	+24.6	+14.8
Southeastern Oregon area (Harney, Malheur counties)	5	26,818,146	25,121,261	22,944,239	+ 6.7	+16.8

BUILDING PERMITS

Building permits are a report of plans rather than of construction in actual operation. Interpretation of these data must allow for time elapsed between the issuing of the permit and the beginning of construction. The information has been collected by the Bureau of Business Research from building departments in local government.

	New Dwelling Units Aug. 1961	*New-non Residential Aug. 1961*	*Additions Alterations & Repairs Aug. 1961*	*Totals Aug. 1961*	*Totals July 1961*	*Totals Aug. 1960*
Albany	$ 125,500	$ 5,615	$ 11,042	$ 142,157	$ 177,575	$ 379,625
Baker	.....	15,000	11,615	26,615	79,875	135,591
Beaverton	86,000	7,165	30,780	123,945	620,095	241,280
Bend	10,000	134,550	29,780	174,330	82,900	88,475
Coos Bay	87,500	328,895	15,170	431,565	277,245	350,422
Corvallis	158,000	40,228	12,490	210,718	150,945	169,409
Eugene	665,840	1,474,137	85,510	2,225,487	772,525	849,085
Grants Pass	50,500	15,070	5,300	70,870	361,075	503,450
Hillsboro	89,495	44,150	164,365	298,010	275,605	182,689
Klamath Falls	13,500	5,000	18,670	37,170	221,885	67,532
La Grande	81,500	35,000	6,700	123,200	577,168	113,442
McMinnville	63,000	31,500	9,830	104,330	57,927	49,687
Medford	447,150	370,967	43,133	861,250	483,800	302,550
Milwaukie	142,620	102,000	3,600	248,220	338,415	89,865
North Bend	52,880	4,647	16,127	73,654	49,794	67,690
Pendleton	22,000	9,000	40,485	71,485	83,316	123,655
Portland	2,217,445	1,570,005	1,462,350	5,249,800	3,876,835	17,334,820
Roseburg	62,432	2,144	.....	64,576	733,996	83,260
Salem	366,300	5,825	265,889	638,014	465,159	1,993,891
Springfield	87,548	66,574	26,699	180,821	94,144	105,892
The Dalles	50,000	.....	29,548	79,548	40,756	98,050
Clackamas County	564,000	35,175	44,775	643,950	794,768	1,192,500
Douglas County	43,960	31,394	13,592	88,946	142,785	300,549
Lane County	1,107,431	546,847	146,584	1,800,862	1,275,310	1,262,664
Marion County	520,950	7,900	24,605	553,455	1,695,942	827,210
Multnomah County	2,350,543	484,440	226,712	3,061,695	2,193,149	2,867,883
Washington County	1,858,930	88,727	108,262	2,055,919	3,565,600	2,499,462
120 other communities	1,889,589	1,348,389	553,561	3,791,539	2,543,587	3,009,366
Totals	$13,214,613	$6,810,344	$3,407,174	$23,432,131	$22,032,176	$35,289,994

Construction. The Bureau of Business Research, in cooperation with the F. W. Dodge Corporation, reports June 1961 construction contracts in Oregon had a total value of $44,435,000. This was an increase of 4 per cent above the total for June 1960. Comparative data, in thousands of dollars, follow:

	June 1961	*May 1961*	*June 1960*
Nonresidential	$16,629	$ 4,651	$11,404
Dwelling units	15,380	14,255	15,851
Public works and utilities	12,426	11,056	15,483
Totals	$44,435	$29,962	$42,738

Nonresidential construction in Oregon in June 1961 totaled 1,428,000 square feet; for the same month one year earlier construction totaled 867,000 square feet.

In June 1961 there were contracts for 1,167 dwelling units, totaling 1,384,000 square feet. For the same month one year earlier there were 1,203 units, totaling 1,447,000 square feet.

July 1961 construction contracts in Oregon had a total value of $28,609,000. This is a decrease of 44 per cent from the total for July 1960. The comparative data below is in thousands of dollars:

	July 1961	*July 1960*
Nonresidential	$ 6,825	$ 9,135
Dwelling units	14,766	11,667
Public works and utilities	7,018	30,132
Totals	$28,609	$50,934

Nonresidential construction in Oregon in July 1961 totaled 524,000 square feet; for the same month one year earlier construction totaled 817,000 square feet.

In July 1961 there were contracts for 1,148 dwelling units, totaling 1,344,000 square feet. For the same month one year earlier there were 909 units, totaling 1,088,000 square feet.

The cumulative total for the first seven months of 1961 shows the value of building contracts in Oregon to be 3 per cent lower than for the comparable period in 1960.

For the 11 western states the cumulative seven months value is 6 per cent higher than for the comparable period in 1960. For the nation, the cumulative value for the first seven months of 1961 was 3 per cent higher than for the same period in 1960. None of the figures in the foregoing paragraphs include public works or utilities.

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